

The
Management
University
of Africa



Sponsored by the Kenya Institute of Management

UNDERGRADUATE UNIVERSITY EXAMINATIONS
SCHOOL OF MANAGEMENT AND LEADERSHIP
DEGREE OF BACHELOR OF COMMERCE

FIN 321 : PUBLIC FINANCE

DATE: 11TH AUGUST 2016

DURATION: 2 HOURS

MAXIMUM MARKS: 70

INSTRUCTIONS:

1. Write your registration number on the answer booklet.
2. **DO NOT** write on this question paper.
3. This paper contains **SIX (6)** questions.
4. Question **ONE** is compulsory.
5. Answer any other **THREE** questions.
6. Question **ONE** carries **25 MARKS** and the rest carry **15 MARKS** each.
7. Write all your answers in the Examination answer booklet provided.

QUESTION ONE

Read the Case Study below carefully and answer the questions that follow:

Public finance in centrally planned economies has differed in fundamental ways from that in market economies. Some state-owned enterprises generated profits that helped finance government activities. The government entities that operate for profit are usually manufacturing and financial institutions, services such as nationalized healthcare do not operate for a profit to keep costs low for consumers. The Soviet Union relied heavily on turnover taxes on retail sales. Sales of natural resources, and especially petroleum products, were an important source of revenue for the Soviet Union. Government participation in economic activities varies according to the philosophy of the State. The proportion of total output produced through Government budget and total income collected in taxes are dependent on the economic doctrine of the State. Besides, the budgetary functions and other ways by which Government actions affect the course of economic activities include monetary, regulatory and other devices. Public enterprises play a significant role in some States whereas they are of less importance in others. Public sector is that segment of an economy whose activities are under the control and direction of the State. The Nation owns all the resources and uses them for either the well-being of the ruling class or that of the society as a whole.

Private sector, on the other hand, refers to that segment of the economy whose activities are under the control and direction of non-governmental organizations. Members of the society own the resources in this sector and use them for the maximization of their goals. Since the public and private sectors interact, both of them should be given consideration. The effects of public tax and expenditure measures are dependent on the reactions of the private sector. Also, the need for fiscal measures is determined by how the private sector will perform. Musgrave stated that the complexity of financial problems which operate through the revenue and expenditure processes of Government is traditionally referred to as 'Public Finance.' Prof. Dalton postulates that Public Finance is that which is concerned with the income and expenditure measures of public authorities. Therefore, Public Finance could be defined as the financial operations of the public sector and the implications

thereof It analyses the effects of government taxation and other revenue sources and state expenditure on the economic situations of individuals, institutions and the whole economy. According to Taylor, Public Finance deals with the finance of the public as an organized group under the institution of government.

Required;

- a) Explain briefly Public Financial Management in reference to the Kenyan Economy (5 Marks)
- b) Taxation is the central part of modern public finance. In your own understanding, clearly differentiate direct tax from indirect tax (4 Marks)
- c) Clearly identify and briefly explain the four (4) key underlying policies of Public Finance (8 Marks)
- d) Discuss four (4) factors causing perennial revenue allocation problems in Kenya (8 Marks)

QUESTION TWO

- a) Studies have generally been concentrated on taxation and the effects of public expenditure on employment and prices. In relation to Public Expenditure, clearly discuss;
 - i. "The Law of Increasing State Activities" (2.5 Marks)
 - ii. "The Displacement Theory" (2.5 Marks)
- b) Briefly highlight the comparison between Government Accounting and Private Sector accounting (10 Marks)

QUESTION THREE

- a) Briefly explain;
 - i. Domestic debt and; (2.5 Marks)
 - ii. External debt (2.5 Marks)
- b) Propose various practical methods that the government can use to manage its debts (10 Marks)

QUESTION FOUR

- a) Define the term Revenue Control and discuss the seven (7) elements of revenue control system in the public sector (15 Marks)

QUESTION FIVE

- a) There are three bases under which the financial statements of a public sector enterprise are compiled; clearly explain each basis below.
- i. The cash basis; (2 Marks)
 - ii. The accrual basis; (2 Marks)
 - iii. The commitment basis (2 Marks)
- b) Describe the advantages and disadvantages of any of the bases listed above (9 Marks)

QUESTION SIX

A number of factors have been identified as inevitably leading to growth in Government spending in many countries over time. Some of these factors are general, and apply to all countries, while others are specific to some developing countries, such as Kenya. Identify and explain the various factors that have led to growth in Government spending. (15 Marks)